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Sent: Tuesday, August 25, 2009 5:18 PM
To: comment, cotce
Subject: Impact of proposed BNRT on small business

August 25, 2009

*Mr Gerald Parsky, Chairman
California Commission on the 21st Century Economy
915 L Street, 8th Floor
Sacramento, CA 95814*

Via E-mail

Dear Chairman Parsky:

I've been following the Commission's work for several months and have read many of the recommendations and letters of support from Northern Californians. I say Northern Californians because there is a disproportionate share of comments from Northern California vs. Southern California, even though Southern California is more populous. Actually, it does give the impression that the Commission's work is primarily on behalf of the northern part of the state. I noticed that a great majority of public comments are from the San Francisco Bay Area and in particular from cities often considered hotbeds of liberal thinking. Although I've been following the Commission's work for some time, I am only now commenting since the committee has finally issued a draft proposal.

Contrary to the theoretical tone I sense from the public comments, my comments are an application of the proposed changes expressed in the Commission's draft proposal released the week of August 21. We have often heard that it is small business that is really the work horse of the American economy and in particular that of California. Having recently had access to the books and records of a proprietorship run in the form of a Sub S corporation, I applied the proposed tax changes to this entity in order to determine the magnitude of the proposal's impact on this business

Real Life Case

This example uses the 2008 financial information of a clothing retailer in San Jose with Annual Gross Receipts of \$941K. After cost of sales and business expenses the business is left with only \$20K per year in taxable income. This alone qualifies the owner for poverty level assistance from the US government in the form of Earned Income Credits (EIC) on his annual federal income tax return. Since the business pays \$172K in wages and \$9,100 in interest expense, under the proposed BNRT, as described in narrative and by the examples provided in the draft, the business would have 2008 BNRT taxable income of \$201,100. According to the examples in the overview, the resultant BNRT would be \$6,033. Since this business owner owes the federal government \$2,780

in self-employment taxes, he is left with \$17,220 per year to feed, clothe and house his family. Assuming that the federal EIC is sufficient to cover the cost of his self-employment tax, the taxpayer at least breaks even with \$20,000 net income from his business. But implementation of the BNRT as described in the draft overview, takes \$6,033 of the available spendable income. This leaves him with only \$13,067 to feed, clothe and house his family. That is a 30.2% drop in his spendable income. Stated another way, he now has an additional 30.2% income tax thanks to the BNRT. Even though the proposed rate is only 3%, using a gross amount converts it to an extremely regressive tax on lower small business owners with low net incomes. Any way you look at it, this simply amounts to taking from the poor struggling to make their business work and provide for their loved ones. Visions come to mind of the Sheriff on Nottingham.

Taxpayer Options

In order to pay the BNRT, this person will have to:

1. Lay-off or fire one or more employees in order to reduce salaries and increase income, which will increase his federal income and SE tax, but may provide the taxpayer with sufficient funds to allow him to pay the BNRT without affecting the money needed to feed, clothe and shelter his family.
2. The taxpayer may opt to misclassify expenses, pay employees under table, thus putting him at odds with the IRS and EDD for payroll tax liabilities. This obviously reduces the state's revenue resources, since he would not be paying SUI or SDI on any wages for any employee not reported. The employee, in turn, will not report any money received, that's not on a form W-2, or
3. The third option is for the taxpayer to close his business and go work for another employer. If he takes this option, the state will now have a number of people that have joined the unemployment rolls, drawing public assistance and putting an added burden on the state's already over-burdened resources.

Any option that the taxpayer chooses is the result of the Regressive nature of the BNRT on Salaries and Wages. I believe this is the exact opposite of what the Commission purports to address. Any method of calculating any tax using salaries and wages as a base is by its very nature regressive and unproductive.

At a recent community organization meeting, Commissioner Keeley stated that he knew of no state that had attempted such a dramatic change in its tax structure. He mentioned the states of Ohio and Michigan as having toyed with the concept of a gross receipts tax but have not actually changed their underlying tax structures. I commented to Commissioner Keeley that the state of Texas was mandated by judicial proceedings to change its franchise/income tax structure. This has now been in effect for the past two years.

Prior to the change in its structure, Texas only levied a franchise tax based on income on corporations. Other entities, such as sole proprietorships, partnerships and other non

corporate forms of business were deemed to be a form of business ultimately owned by a natural person and therefore exempt from the franchise tax under Texas law. The change in the structure truly brought out reform in Texas, because rather than have the franchise tax paid by a few thousand corporate taxpayers (the rich), the tax was spread out among all taxpayers. Commissioner Keeley, talked about a low rate BNRT at 3%. When applied to gross revenue, this low 3% tax becomes excessive. In contrast, the tax in Texas is .0575, and taxpayers on the lower end are exempted or credited up to \$100K in tax. So effectively, no business in Texas pays a tax unless their tax exceeds \$100K. At 3%, the proposed BNRT is close to 60 times that of the state of Texas. If the Commission recommends and the state passes a gasoline Carbon Tax in addition to the BNRT, these taxes will not only have a dire effect on businesses that rely on fuel, but will also have a devastating effect on anyone trying to earn a self-employed income at, or near, the poverty level.

Because the BNRT, as proposed, is in effect a penalty on hiring employees and paying salaries and wages. It is easy to understand how smaller businesses, particularly those that are mobile and depend on labor, such as the construction trades, landscapers, gardeners, plumbers, handy-persons, independent businesses of all types, may be encouraged to understate their total annual payrolls. This is already taking place, but it has the potential to expand by leaps and bounds. It has the potential for increased collection and enforcement burdens on the state. Those companies which are traditionally accused of under reporting and underpaying their taxes are the least likely to under state their payroll costs. The reason for this is they have the resources to simply shift labor costs from within California to outside California. However, the revenue service(s), EDD, BOE, or FTB can be counted on to place their enforcement efforts on the larger California businesses because their auditors can claim to have audited a large payroll amount. However, its the smaller businesses that will have the incentive to mis-state payroll.

Criticism of the BNRT and the Carbon Tax in now way implies endorsement of the Split-roll. By passing Prop 13, the taxpayers of California obliquely demanded a slow-down in the growth of California government by limiting the amount of revenue counties could raise. Politicians have deemed it not in their interest to follow the mandates of the people of California and have continued to spend at unparalleled levels. The basic structure of the California property tax should not be changed simply to find a way of taxing perceived inequities. Many of the recommendations noted in the Commission's correspondence page, show a lack of practical experience. The only commentator with any experience is Santa Clara County's Assessor, Larry Stone. Mr. Stone has been an opponent of Proposition 13, for as long as I've known him. However, even he, in his comments to the Commission, argues against a split roll; albeit for practical reasons.

When considering the many public comments it has received, I encourage the Commission give more weight to the comments presented by individuals and organizations that have experience in dealing with a broad range of tax matters. While it may be attractive to embrace theoretical concepts or studies, theory is often flawed until proven and I learned early in my career that statistics can be easily manipulated to suit a researcher's specific point of view. Whether the view be political, scientific, or

academic. Statistics are only as good as the impartiality of the data and the integrity of the statistician.

Below, I have provided the calculations I used in the real life case I presented above.

6770	Salaries & Wages	172,016.91
7530	Interest Expense	9,088.93
	Net Income	<u>20,000.00</u>
		201,105.84

BNRT Rate 3.00%

BNRT 6,033

	Pre-BNRT	Post BNRT
Business Income	20,000.00	20,000.00
Tax	<u>-</u>	<u>6,033.00</u>
Spendable Income.	20,000.00	13,967.00
Percent change in income		30.2%
\$6,033 / \$20,000		

In closing I wish to thank the Commission for providing for free and open input from the general public.

Sincerely,

Pedro Rincon

Santa Clara